

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
3538 WILSHIRE CORP., ET AL. }

Appearances:

For Appellant: Robert L. Spencer, Certified Public
Accountant; Irving M. Peretz, Comptroller

For Respondent: Burl D. Lack, Chief Counsel;
Crawford H. Thomas, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of 3538 Wilshire Corp., et al., to a proposed assessment of additional franchise tax in the amount of \$103,586.45 for the income year ended September 30, 1953.

Tishman Realty & Construction Co., Inc. (hereafter referred to as "Tishman") qualified to do business in California on June 7, 1948. In January, 1950, it acquired an option to purchase certain land located at 3440-50-60 Wilshire Boulevard in Los Angeles. During 1950 Tishman incorporated two wholly-owned subsidiaries, 3440 Wilshire Corp. and 3462 Wilshire Corp. ("3440" and "3462"). Land designated 3440 Wilshire Boulevard was conveyed to 3440 and land known as 3450-60 Wilshire Boulevard was conveyed to 3462. These corporations gave Tishman their obligations for the cost of this land.

Construction of a three-section building on the land commenced. When completed, it was known as 3450 Wilshire Boulevard. A general construction contract was given to a construction company on a cost-plus basis, and construction was supervised by a wholly-owned Tishman subsidiary.

Tishman temporarily advanced the funds to 3440 and 3462 for expenses until a construction loan from the Irving Trust Company, totaling \$5,480,000, was arranged. This loan was repaid in May, 1952, when, after completion of the building, Prudential Insurance Company of America ("Prudential") provided conventional financing in the form of a \$7,525,000 loan secured by mortgages. After the building was completed, 3440 and 3462 rented space in it to tenants.

On September 11, 1952, Prudential wrote Tishman that purchase of the entire 3450 Wilshire Boulevard property at a price

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of \$11,000,000 with simultaneous leaseback to a wholly-owned Tishman subsidiary had been authorized by Prudential's Board of Directors. Tishman was asked to indicate acceptance of these terms.

Another subsidiary, 3450 Wilshire Corp. ("3450"), was formed by Tishman early in 1953. On March second of that year, 3440 and 3462 consummated the sale of the property to Prudential, and on the same day Prudential leased it to 3450 for a term of 14 years with four renewal options of 21 years each. In order to exercise the first 21-year option, the lessee was required to make a payment of \$1,350,000. As a condition of the agreement the vendors of the property deposited \$990,000 as security for the lessee's performance of its lease obligations, the deposit to be returned after the fifth lease-year. Tishman was required to guarantee the lease payments to Prudential. Prior to the end of their fiscal year, September 30, 1953, 3440 and 3462 dissolved. Tishman withdrew from this State in October, 1953. After acquiring the lease, 3450 rented space in the building to tenants through a property management company.

The liability of 3440 and 3462 for franchise taxes was assumed by 3450. In 1956, 3450 sold the lease on the Wilshire property and dissolved. Its franchise liability was assumed by 3325 Wilshire Corp. whose liability was assumed, on dissolution, by 3538 Wilshire Corp., the named Appellant. All corporations were **Tishman subsidiaries**.

The sale of the Wilshire property in 1953 resulted in a gain of \$906,548.10 to 3440 and a gain of \$2,015,157.54 to 3462. The franchise tax, a tax paid for the privilege of doing business within this State, with exceptions not relevant here, is measured by applying the tax rate to the net income of the corporation for the preceding year. (Revenue and Taxation Code, §23151.) Thus, if a corporation ceases to do business in California because of dissolution or withdrawal, no tax is measured by the income earned by the firm during the year it ceases to do business. Since the gain on the sale by 3440 and 3462 was realized in the same fiscal year that they dissolved, no franchise tax has ever been paid on this gain.

The Franchise Tax Board takes the position that the gain realized by 3440 and 3462 should be included in the measure of the tax on 3450 for the taxable year ended September 30, 1954, under Section 23253 of the Revenue and Taxation Code. This section provides that where all or a substantial portion of a taxpayer's business or property is transferred, pursuant to a reorganization, to another taxpayer, the net income of the transferor for the taxable year in which the transfer occurs should be included in the measure of the tax on the transferee for the taxable year

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succeeding the year in which the transfer occurs. For the purpose of applying this provision, Section 23251 defines "reorganization" as follows:

(a) a transfer by a . . . corporation of all or a substantial portion of its business or property to another . . . corporation if immediately after the transfer the transferor or its stockholders or both are in control of the . . . corporation to which the assets are transferred; or (b) a mere change in identity, form or place of organization however effected; or (c) a merger or consolidation; or (d) a distribution in liquidation by a . . . corporation of all or a substantial portion of its business or property to a . . . corporation stockholder, and the . . . corporation stockholder continues all or a substantial portion of the business of the liquidated . . . corporation.

The foregoing provisions were enacted to prevent the avoidance of franchise tax that would otherwise be possible by a mere change in the corporate structure. (See San Joaquin Ginning Co. v. McColgan, 20 Cal. 2d 254.)

The San Joaquin case made it clear that the reorganization provision should be liberally construed so as to include any procedure which changes the corporate structure without substantial change in the business operations and interests involved. Thus a mere change in form, without a change of substance, will not avoid payment of franchise taxes which otherwise would be due.

Prior to the sale and leaseback of the building in question, 3440 and 3462 rented space in the building to tenants and were completely controlled by Tishman. Thereafter 3450 rented space to tenants in the same building and that corporation was completely controlled by Tishman. Before the transaction, 3440 and 3462 operated the business as owners of the building subject to mortgage payments while 3450 operated the business under a long term lease subject to payments under the lease. Appellants argue that this constituted a substantial change in the business enterprise, preventing the operation of Section 23251.

Appellant's argument would be entirely foreclosed if 3440 and 3462 had leased back the property themselves and had then transferred the lease to 3450. In essence, that is exactly what occurred. The sale and the lease were inextricably related, the lease on prearranged terms being a part of the consideration to which 3440 and 3462 were entitled in making the sale to Prudential. Those corporations transferred the lease to 3450 through Prudential as a conduit, just as effectively as if the transfer

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were made directly by them. To conclude that the effect of the arrangement is significantly changed merely by the artificial device of splitting the transaction through a sale by the two controlled corporations and a prearranged leaseback to another unjustifiably exalts form over substance. The complete control exercised by Tishman, its ability to negotiate the entire terms of the sale and leaseback package and the lack of practical importance to Tishman as to which wholly-owned subsidiary was the nominal lessee are additional circumstances which undermine the significance of the sequence of formalities followed in carrying out this transaction.

This Board is of the opinion that the sale and lease arrangement resulted in a reorganization within the meaning of subdivision (a) of Section 23251, as a transfer of business or property between corporations controlled by the same interests and is also encompassed by subdivision (b) of that section, which applies to "a mere change in identity [or] form . . . of organization however effected." (Emphasis added.)

O R D E R

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of 3538 Wilshire Corp., et al., to a proposed assessment of additional franchise tax in the amount of \$103,586.45 for the income year ended September 30, 1953, be and the same is hereby sustained.

Done at Sacramento, California, this 19th day of July, 1961, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Richard Nevins, Member

_____, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary